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SUBJECT: FOREIGN INVESTORS LEERY AS SHIN INVESTIGATION WIDENS

REFTEL: BANGKOK 538, BANGKOK 1549

11. Summary: The Ministry of Commerce is wrapping up an investigation into possible illegal foreign ownership structures arranged for the sale by Prime Minister Thaksin of telecommunications giant Shin Corporation, an investigation which at least in theory could have far-reaching effects on foreign investment in Thailand. The use of holding companies and nominee firms to skirt foreign ownership restrictions is common practice, though of questionable legality, and both new and established investors may also come under scrutiny. Most U.S. investors are not affected as their investments were arranged under the U.S.-Thailand Treaty of Amity or under investment promotion privileges by the Board of Investment, both of which allow for majority foreign ownership. Although foreign investors risk being dragged into the fray, U.S. investors here discount that risk, reasoning that the Shin deal is indeed a very special case, and that both the government and its opponents have made it clear that they recognize the value of foreign investment and are substantially more interested in legalizing and making transparent foreign ownership rather than further restricting it. The issues raised by the Shin sale have led to a renewed interest here in modernizing foreign investment rules, a development we may be able to leverage in our FTA talks. While our concerns have been allayed somewhat by the calm reaction from many investors, we still plan to seek clarification on investment rules from the Ministry of Commerce. End Summary.

Shin under the microscope again  
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12. In a controversial January 2006 deal, Singaporean investment firm Temasek Holdings purchased a 49 percent share of Shin Corporation from caretaker Prime Minister Thaksin Shinawatra (see reftels). The sale of Shin sparked an outcry among PM Thaksin's critics as details of the USD 1.9 billion deal emerged, including that Thaksin structured the sale in such a way that he was not required to pay tax.

13. Opposition Democrat Party members requested the Ministry of Commerce to investigate the ownership structure of the Shin deal, alleging that the Thai majority shareholders of Shin were in fact stand-ins for Temasek, or "nominees", a possible violation of Thailand's Foreign Business Act (FBA) which restricts foreign business ownership in service sectors to 49 percent. On paper the deal seemed to comply with the law. Typical of nominee structures here, the Shin transaction was effected via a bewildering series of shell companies: Temasek's purchase of Shin involved several holding companies created specifically for this transaction, with Temasek maintaining a minority position in many of them. The majority holder of Shin is Cedar Holdings, a Thai-owned firm thanks

to its ownership by yet another holding company, Kularb Kaew, which lists a number of Thai businessmen as controlling partners. Technically this makes Shin Corp. Thai-owned; however, Kularb Kaew's Thai partners reportedly have limited voting rights and dividends from Shin and may not be full partners in the venture.

¶4. In a widely reported but unreleased preliminary decision, the Ministry's Department of Business Development found that Kularb Kaew was indeed a nominee, holding shares for Temasek to help it avoid foreign ownership limits. Article 36 of the FBA prohibits Thai nationals from acting as a nominee, though crucially the Act fails to define precisely what constitutes a nominee firm. Under the Act, if Kularb Kaew is found to be a nominee its Thai owners are subject to fines and a maximum of three years imprisonment, and the company can be dissolved.

Umm, wasn't that Pandora's Box?  
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¶5. Scrutiny into Temasek's use of nominees in the purchase of Shin has unnerved other investors in Thailand, worried that their own opaque arrangements could be called into question. Although Thai law has clearly restricted majority foreign ownership since 1972, the ample presence of foreign businesses suggests otherwise. In practice, foreign investors have long used nominee companies to skirt these limitations. The use of nominee companies for this purpose has been obvious to everyone, including successive Thai governments, which have tolerated -- and, it is argued, implicitly endorsed -- the practice. This solution is "very Thai:" the political attractiveness of a law that severely limits foreign participation in a large part of the economy is maintained, while at the same time the practical need for foreign capital and expertise is accommodated. Business analysts estimate that thousands of foreign businesses potentially would be affected by a stringent

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application of the regulations. A recent study by economic think tank Thailand Development Research Institute concluded that nominees held 24.1 percent of shares in all listed companies on the SET, about one trillion baht (USD 26 billion) in share value.

¶6. Ownership restrictions have led investors to create patchworks of ownership vehicles to comply with the letter, if not the spirit, of the law. A typical business arrangement involves a Thai firm holding a majority share in the operating company with a foreign investor holding a minority share. However, the Thai firm is typically owned in part by the foreign investor, giving the foreign investor a majority economic interest, but still providing the appearance of Thai majority ownership. Nominees often control 51 percent of a company on paper, but in practice the shares they hold have limited voting rights and no entitlement to dividends. In some cases the foreign investor lends money to the Thai firm to purchase the majority share, and then holds the shares as collateral for the loan, effectively controlling all shares. For many smaller deals, the law firm that structures the deal acts as nominee; small law firms can be majority partners in literally hundreds of businesses.

¶7. In the past, the Ministry of Commerce interpreted ownership nationality by actual shareholdings, and did not consider the level of economic interest or control. In a number of challenges to nominee structures over the years, the RTG consistently amended foreign ownership regulations to define a company's nationality by shareholdings rather than control.

¶8. To crack down on the use of nominees the Ministry is implementing new regulations. Effective August 15, the Ministry requires registrants of new partnerships and limited companies that include foreign shareholdings of more than 40 percent to submit six months of bank statements as evidence that the Thai partners have sufficient capital to undertake the investment. The Ministry also has authority to examine existing businesses to verify that their ownership complies with the law, but limited manpower in the Ministry virtually guarantees that investigations will not be widespread. In a related move, the Ministry of Interior notified all provincial governors on May 15 that land purchases involving foreigners be examined for illegal use of nominees. The SET has

also announced that it plans to require public disclosure of the identity of shareholders who have at least a five percent stake in a listed company.

¶9. The new Commerce regulations have yet to prevent new investors from using nominees. Local lawyers noted that the regulations applied to companies with more than 40 percent foreign ownership; one law firm submitted two new business registrations last week with 39 percent foreign ownership that were approved without further scrutiny. In addition, Commerce intends to examine initial business registrations closely, but is not clear on how it will handle recapitalizations. In theory a foreign investor could initially set up a structure with genuine Thai investment, then recapitalize with foreign money giving him majority control without raising any eyebrows at Commerce.

#### U.S. Saved by the Treaty

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¶10. Nearly all U.S. investors have managed to legally acquire majority control by setting up their investments under the U.S.-Thailand Treaty of Amity and Economic Relations (AER) or by using investment promotion privileges granted by the Board of Investment (BOI). The AER offers national treatment for U.S. investors, allowing majority ownership in all but six protected sectors, including inland communications, inland transportation, fiduciary and depositary operations, domestic agricultural trade, and land and resource exploitation. Land ownership is also restricted, with some exceptions for industrial estates, BOI-promoted investment, and petroleum concessionaires.

¶11. While a theoretical case can be made that U.S. investment in Thailand could be harmed by the fall-out from the Shin deal, U.S. investors here seem unconvinced that, in practice, there is any problem. In response to our inquiries, local lawyers and the American Chamber of Commerce have been unable to name a single U.S. company that in their view could be affected by more stringent application of foreign ownership limits (though we continue to canvass the U.S. business community). Amcham speculates that smaller companies that wished to own land (which under Thai law is illegal) may have entered into a nominee ownership structure and could be subject to review. Even in these few cases, however, precedent suggests that these companies would be given without penalty an opportunity to change their structures to bring them into compliance with Thai law.

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#### Commerce pulls back the reins

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¶12. Soon after the Ministry of Commerce reportedly made a preliminary ruling that Temasek had indeed used nominees to purchase Shin, officials announced that a new committee would be formed to consider the broader implications of the investigation. The committee includes members from the Securities and Exchange Commission, Finance Ministry, Bank of Thailand and the Council of State. The committee's main task will be to more precisely define "nominee", a task that Deputy Minister Preecha Laohapongchana said could take two to three months.

#### Democrats kick the political football

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¶13. The opposition Democrat party has made hay on both Temasek's alleged use of nominees and the Ministry of Commerce's suppression of the investigation's findings, calling for a prompt disclosure of the Ministry's report. At the same time, party leaders say they recognize the value of foreign investment and have called for liberalization of foreign ownership limits, thus obviating the need for complex, non-transparent nominee structures.

¶14. In a meeting with Embassy officers, MP Kiet Sittheeamorn said the Democrat Party was pursuing the Shin case because it was a "particularly egregious" example of the use of nominees, so blatant that it could not be overlooked. He implied that the party had no

interest in initiating investigations into other businesses and criticized Thai Government officials for resorting to what he regards as scare tactics in suggesting that other foreign investments may be in jeopardy.

The way out

¶15. Business observers say Commerce will likely drag out the Shin investigation as long as practicable while searching for an acceptable conclusion to the case. One possible scenario suggested to us by a major property developer is that Commerce will simply declare that the Shin deal was not in compliance originally, but post-deal shifts in ownership have met legal requirements. This short-term non-compliance would be subject to a modest fine. In the meantime, Commerce would amend the FBA to clarify the definitions of nominee and foreign ownership in such a way as to reassure investors while still protecting sensitive sectors.

¶16. The upside of the Shin investigation is that it has sparked a salutary debate on foreign investment in Thailand. Driving through Bangkok, the most casual observer will see ample evidence that foreign investment in "Thai-only" sectors is rampant. Overly broad restrictions have spawned a web of complicated ownership structures across many sectors and have not provided the control over key sectors that the law intended. Many here are calling for a realistic reappraisal of Thai investment law, with changes including dismantlement of blanket restrictions on foreign ownership. In place of current restrictions, analysts recommend a more confined list of protected sectors together with a structure to more closely analyze investments in these specific sectors.

¶17. Comment: Temasek's non-transparent but not uncommon ownership arrangement for its takeover of Shin Corporation has provided yet another opportunity for PM Thaksin's opponents to criticize his personal and public policies. Although foreign investors risk being dragged into the fray, U.S. investors here discount that risk, reasoning that the Shin deal is indeed a very special case, and that both the government and its opponents have made it clear that they recognize the value of foreign investment and are substantially more interested in legalizing and making transparent foreign ownership rather than further restricting it. We believe the renewed interest here in services liberalization may facilitate progress in this area in the context of our FTA talks.

¶18. The level of concern varies among individual investors, with many respected observers holding sharply diverging opinions on how the Shin investigation will affect the overall investment climate. We are reassured that many U.S. investors feel their businesses will be unaffected, but nevertheless plan to seek clarification from the Ministry of Commerce on how foreign ownership regulations will be interpreted or amended. We also will continue to canvass the U.S. business community on this issue and report their concerns.

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